Chapter Thirteen: Death Benefits

Benefits payable

TRS provides two types of death benefits:

- a refund of any remaining accumulated contributions and
- monthly or lump-sum survivor benefits.

These benefits may be paid to separate beneficiaries or both benefits may be paid to the same beneficiaries.

TRS must have a certified copy of the deceased member's or annuitant's death certificate on file before death benefits can be processed. Other supporting documents also may be required.

Designation of beneficiaries

To designate beneficiaries, members must complete a Member Information and Beneficiary Designation (MIBD) form. If TRS does not have an MIBD form on file for the member, death benefits are distributed as follows:

- a return of any accumulated contributions is paid to the member's surviving spouse or, if none, to the member's estate and
- survivor benefits are paid to an eligible dependent beneficiary or, if none, to the member's estate.

The beneficiaries designated for the refund of accumulated contributions and survivor benefits will be noted in the "Beneficiary Information" section of the member's Personal Statement of Benefits.

Members and annuitants may change beneficiary designations at any time and should review their designation periodically. Members may verify their beneficiary designation by contacting TRS. To change beneficiaries, a new MIBD form must be completed. A supply of MIBD forms is mailed to all TRS-covered employers in July. MIBD forms are also available through the 24-hour Forms Order Line, through the TRS Web site, and at both TRS office locations.

Types of beneficiaries

The type of benefit for which survivors are eligible is determined by the survivor's status at the time of the member's death. Monthly survivor benefits can be paid only to dependent beneficiaries.

A **dependent beneficiary** is

- a spouse to whom the member has been married for at least one year, except where a child is born of the marriage in which case the one-year period is not applicable;
- an unmarried natural or adopted child under age 18, or between ages 18 and 22 if he or she is a full-time student in an accredited educational institution, or an unmarried child of any age who is dependent by reason of a physical or mental disability and who is not receiving benefits under the Illinois Public Aid Code, Article III, or
- a dependent parent who received at least half of his or her support from the member for the 12-month period immediately prior to the member's death.

For an adopted child to be an eligible dependent beneficiary, the adoption proceedings must have been finalized while the child was a minor. For purposes of determining dependency, "disability" is defined as an inability to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to last for a continuous period of 12 months or more. A parent may be an eligible dependent beneficiary only if there is no other dependent beneficiary. A survivor benefit may be paid to a trust established during the member's lifetime or at the time of death for dependent beneficiaries provided the trust specifically mentions TRS and states that the survivor benefits will be used solely for the care and benefit of the dependent beneficiary.

A surviving spouse must send TRS a copy of the couple's marriage license or, if this is not available, a religious record of marriage. If these documents are not available, TRS will accept:

- a notarized statement from the individual who performed the marriage,
- notarized statements from at least two individuals in attendance at the marriage,
- written certification from the Social Security Administration of the marriage ceremony and its date, or
- a copy of a federal or state tax return that was filed in the year preceding death.

A certified copy of the declaration or decree entered by a court is the only documentation acceptable as evidence of dissolution or invalidity of marriage. The surviving spouse must also provide a copy of his or her own birth certificate. Birth certificates for any minor children of the member are also required.

A **nondependent beneficiary** is any other designated person or entity that is not a dependent beneficiary.

A member may designate a primary beneficiary on the MIBD form to receive survivor benefits. If this individual is a dependent beneficiary, he or she may select either monthly benefits or a lump-sum benefit. Only a lump-sum benefit is payable if the member designates both a dependent and a nondependent primary beneficiary.

Alternate beneficiaries named on the MIBD form will receive benefits only if all designated primary beneficiaries predecease the member. If the member's beneficiary designation includes more than one person, the benefits are divided equally among the living beneficiaries of that class (primary or alternate).

The *automatic designation* option on the MIBD form is an alternative to naming specific individuals. Automatic designation names all eligible dependents as beneficiaries. If no dependent beneficiaries survive, the benefits are paid to the member's estate.

Refund of accumulated contributions

Accumulated contributions are returned as a lump-sum payment.

Beneficiaries of active and inactive members will receive a return of the member's retirement contributions (7.5 percent as of July 1, 1998), plus interest, and the 0.5 percent contribution paid towards the annual increase in annuity. The member's Personal Statement of Benefits lists the contributions and interest that are refundable after death.

Beneficiaries of annuitants will receive accumulated contributions minus the amount the member received as a retirement annuity.

Survivor benefits

Eligibility

Beneficiaries are eligible for a *lump-sum* survivor benefit if the member's death occurs:

- while the member is an annuitant;
- while the member is employed as a teacher;
- within the first 12 months following the member's last day of earnings as a teacher;
- while the member is on an approved leave of absence;
- while the member is receiving a nonoccupational or an occupational disability benefit;
- while the member is an inactive member and has 20 or more years of service.

For the purpose of determining eligibility for a benefit, service credit under the State Employees' Retirement System of Illinois, the State Universities Retirement System, and the Public School Teachers' Pension and Retirement Fund of Chicago is considered.

Dependent beneficiaries are eligible for *monthly* survivor benefits if the member had 1.5 years of TRS service credit and at least 60 days of creditable service during the 18 months preceding his or her death.

For an inactive member with fewer than 20 years of service, no survivor benefits are payable unless the member returns to teaching or starts receiving a retirement annuity.

For an inactive member who had established 20 or more years of service credit, his or her beneficiaries are eligible for survivor benefits calculated as though the member had been in retirement at the time of death.

For an annuitant having at least one year of service after July 24, 1959, his or her beneficiaries are eligible for survivor benefits, provided that the annuitant had not taken a refund of those contributions prior to death. For an annuitant who did *not* have service after July 24, 1959, and died after January 1, 1982, his or her surviving *dependent* beneficiaries are eligible for survivor benefits up to a maximum of $200 per month plus a $1,000 one-time, lump-sum payment.

A monthly survivor benefit payable to a dependent beneficiary may be paid to a trust provided the trust meets certain requirements. Please call TRS at (800) 877-7896 if a trust is being considered for beneficiary designation. (See information under "Types of beneficiaries.")

Methods of payment

The survivor benefit is paid in one of two mutually exclusive ways:

- lump-sum payment or
- monthly benefit payments (available only to dependent beneficiaries).

Lump-sum payment

A lump-sum payment is the only method of survivor benefit payment for nondependent beneficiaries. A dependent beneficiary may choose either a lump-sum payment or monthly benefit payments.

Beneficiaries of active and inactive members

For an active member or an *eligible* inactive member who has fewer than 20 years of service credit, the lump-sum benefit amount the beneficiaries will receive is equal to 1/6 of the member's highest salary rate within the last four years of service times the number of completed years of TRS service. The *minimum benefit* equals 1/6 of the member's highest salary. The *maximum benefit* equals 100 percent of the member's highest salary.

Example:

Assume the member had 4.5 years of service credit (use only completed years). The member's highest salary was $21,300.

Highest salary	$21,300
4 ÷ 6	x .66667
Lump-sum benefit	$14,200

Beneficiaries of annuitants

For an annuitant or an inactive member who has 20 or more years of service credit, the lump-sum benefit his or her beneficiaries will receive is equal to the *greater* of:

- the annuitant's highest annual salary rate within the last four years of service reduced by 1/6 for each year or partial year since the date the annuitant retired or terminated service to a minimum of 1/6 of the annuitant's highest salary rate,
- the annuitant's survivor benefit contributions, or
- $3,000.

Example:

Assume the annuitant's highest salary within the last four years of service was $40,000 and his or her survivor benefit contributions totaled $6,000. The annuitant had been retired 3.5 years at the date of death. The lump-sum benefit is the greater of:

a. (6 ÷ 6) - (4 ÷ 6) = 2/6
   2 ÷ 6 x $40,000 = $13,333
b. $6,000, or
c. $3,000

The lump-sum benefit equals $13,333.

Monthly payments

Monthly payments can be made only to surviving *dependent* beneficiaries or to a qualifying trust established for a surviving dependent beneficiary. These payments may be electronically deposited into a beneficiary's bank account through direct deposit.

A spouse of a active or inactive member can receive this benefit immediately if the spouse has surviving minor children. Otherwise, provided the spouse was married to the member for at least one year, the benefit is payable when the spouse reaches age 50 or from the member's date of death if the surviving spouse was at least age 50 at the time of the member's death. A dependent parent may receive benefits at age 55 or from the date of the member's death if the parent was at least age 55 at the time of the member's death.

Beneficiaries of an annuitant will receive this benefit effective the first of the month following the member's death only if the spouse is age 50 or has a dependent child or dependent children. If the spouse is not age 50 at the time of the member's death and does not have a dependent child or dependent children, the benefits will be effective when the spouse reaches age 50. The retirement annuity is payable through the month of the member's death.

Beneficiaries of active or inactive members

The monthly payments for a surviving dependent beneficiary of an active member or an *eligible* inactive member who had fewer than 20 years of service credit includes:

1. a $1,000 one-time, lump-sum payment *plus*
2. monthly income as follows:
   a. one dependent - the *lesser* of 30 percent of the member's average monthly salary or $400 per month.

      Assume the average salary is $45,000

      $45,000 x 30% = $13,500 ÷ 12 = $1,125 monthly benefit

      $400 is less than $1,125, so the monthly benefit is $400.

   b. spouse and one child - the *lesser* of 60 percent of the member's average monthly salary or $600 per month.

      Assume the average salary is $45,000

      $45,000 x 60% = $27,000 ÷ 12 = $2,250

      $600 is less than $2,250, so the monthly benefit is $600.

   c. spouse and two or more children - the lesser of 80 percent of the member's average monthly salary or $600 per month.

   d. other combinations of dependent beneficiaries - varying amounts not to exceed 80 percent of the member's average monthly salary or $600 per month, whichever is less.

If 50 percent of the member's earned monthly retirement annuity payable at the later of age 60 or the date of death is greater than the preceding calculations, then this amount **(the minimum benefit)** is what the beneficiary will receive each month.

Average monthly salary is the average of the member's annual salary rate for the highest four consecutive years within the last 10 years of creditable service immediately preceding death divided by 12 or the average monthly salary for the total period of creditable service if service is fewer than four years.

Beneficiaries of annuitants

The monthly payments made to a surviving dependent beneficiary of an annuitant or an inactive member with 20 or more years of creditable service will never be less than 50 percent of the annuitant's gross monthly retirement annuity at the time of death. A dependent beneficiary who chooses the monthly payments receives:

1. a $1,000 one-time payment *plus*
2. a minimum monthly benefit of 50 percent of the annuitant's gross retirement annuity at the time of death. Beneficiaries of an *eligible* inactive member will receive 50 percent

of the member's earned retirement annuity payable at the later of age 60 or the date of the member's death. However, the beneficiary's monthly payment may be greater if the *lesser* of the following is more than 50 percent of the annuitant's annuity:

a. 30 percent of the annuitant's final average salary divided by 12,

b. $400 per month, or

c. 80 percent of the annuitant's original monthly retirement annuity at age 60 or 80 percent of the *eligible* inactive member's retirement annuity payable at age 60.

Example:
Assume the annuitant's current retirement benefit is $1,420.

- The minimum survivor benefit is $710. ($1,420 x .50 = $710)
- The average salary was $24,360. Average salary divided by 12 is $2,030. The original monthly retirement annuity was $980.

  a. $2,030 x .30 = $609

  b. $400 or

  c. $980 x .80 = $784

The lesser of a, b, or c is $400. The monthly payment your beneficiary will receive is $710.

Duration of monthly benefits

Monthly survivor benefits will continue for the life of the spouse. A dependent child will receive benefits until he or she reaches age 18 (or age 22 if he or she is a full-time student), marries, or dies, whichever is earlier. An adult child who is dependent by reason of a physical or mental disability may receive monthly survivor benefits for his or her lifetime if:

- no benefits are otherwise payable on his or her behalf under the Illinois Public Aid Code, Article III,
- he or she does not marry,
- he or she is not capable of substantial gainful employment, and
- we periodically receive a physician certification verifying his or her continuing disability.

Survivor benefits are payable through the end of the month in which the beneficiary's death occurs. No further benefits are payable.

Annual increases in benefits

Recipients of monthly survivor benefits are eligible for a 3 percent increase of the current benefit distributed as follows:

- For beneficiaries of *annuitants*, benefit increases are applied on January 1 after the survivor benefit has been granted.
- For beneficiaries, of *active or eligible inactive members*, benefit increases are applied on January 1 following the first anniversary of receiving the survivor benefit.

Application procedures

To report the death of a member, please call TRS at (800) 877-7896. When notifying TRS of the member's death, provide the deceased member's name, Social Security number, and date of death. TRS will forward a letter and the appropriate forms to the member's designated beneficiaries for completion. The application requires that beneficiaries provide a certified copy of the member's death certificate as well as copies of marriage and birth certificates for surviving spouses.

If the member was an active teacher at the time of death, the school district will need to complete a Supplementary Report and return it to TRS. TRS will calculate a lump-sum and monthly benefit option.

The dependent will receive a Survivor Benefits Election form to select either a monthly benefit or a lump-sum payment. This form will be accompanied by information regarding direct deposit of payments, federal income tax withholding, the Teachers' Retirement Insurance Program (TRIP), and the taxability of survivor benefits. Once TRS receives the completed election form and all other required documents, benefits will be processed and then issued by the Office of the Comptroller.

An annuitant's retirement benefit is payable through the end of the month in which his or her death occurs. We issue payments at the end of the month for the preceding month. Any payments issued to the annuitant beyond the month of death must be returned to TRS.

Payment of accumulated contributions

General rule

As a general rule, previously taxed accumulated retirement contributions returned to survivors of TRS members are excluded from taxable income. Contributions not previously taxed and interest on contributions are included in taxable income in the calendar year in which the contributions and interest are received by the beneficiary. The taxable portion of the payment is treated the same as ordinary income, unless one of the special tax treatments described below applies.

Special tax treatments

The payment may be eligible for special tax treatments if it qualifies as a "lump-sum distribution." A lump-sum distribution is a payment, within one tax year, of the entire amount payable from TRS on account of the deceased member or annuitant. The special tax treatments are not available, however, if any portion of a distribution from TRS has been rolled over into a qualified retirement plan. Additional restrictions are described in the instructions to IRS Form 4972.

The special treatments available for payments that qualify as lump-sum distributions are:

1. **Ten-year averaging.** If the deceased had attained age 50 prior to January 1, 1986, the beneficiary may be able to elect to figure the tax on the payment using the 10-year averaging method using 1986 tax rates, instead of five-year averaging using current tax rates. Like the five-year averaging rules, 10-year averaging often reduces the tax owed.
2. **Capital gain treatment.** If the deceased had attained age 50 prior to January 1, 1986, the beneficiary may be able to elect to have the part of the payment that is attributable to the member's pre-1974 membership (if any) taxed as long-term capital gain.

Rollover

A beneficiary who is a surviving spouse of a member may elect to roll over the taxable portion of a lump-sum payment and thereby defer taxation until the amount rolled over is later received. A surviving spouse can either request that TRS make a direct rollover or elect to receive the payment and then roll it over within 60 days. However, if a direct rollover is not requested, 20 percent of the taxable portion of the payment must be withheld. Direct rollovers are not available to nonspouse beneficiaries.

Surviving spouses should read the sections entitled "Survivor benefits" and "Federal tax withholding." These sections provide important information concerning rollovers and mandatory federal tax withholding at a rate of 20 percent from the taxable portion of the lump-sum payment if a direct rollover is not requested.

Payment of survivor benefits

Monthly annuity payments

Survivor benefits that are paid in the form of a monthly annuity are taxable income in the calendar year during which they are received by the beneficiary. However, if the member's contributions for survivor benefits were made on an after-tax basis, a portion of each annuity payment is nontaxable until all of the after-tax contributions have been returned. The nontaxable portion of each monthly payment is determined by allocating a portion of the after-tax contributions to each annuity payment to be made during the expected payment period. Monthly payments are fully taxable after all of the after-tax contributions have been returned.

Lump-sum payments

The rules summarized previously that apply to payment of accumulated contributions also apply to survivor benefits paid in a lump sum:

- If the payment qualifies as a "lump-sum distribution," the beneficiary may be able to compute the tax using the special income averaging and capital gain treatments. If the payment does not qualify as a lump-sum distribution, the taxable portion of the payment will be taxed as ordinary income.
- If the payment is made to the surviving spouse, the surviving spouse can elect to defer the payment of tax by rolling over the taxable portion of the payment. The surviving spouse can request a direct rollover or receive the payment and later make a rollover within 60 days. A surviving spouse should read the sections entitled "Benefits to a surviving spouse" and "Federal tax withholding." These sections provide important information regarding direct rollovers and the mandatory federal income tax requirement that applies if a **direct** rollover is not elected. Note that if the payment qualifies as a lump-sum distribution, the surviving spouse may be able to elect to use the special income averaging and capital gain treatments, but not if there has been a rollover of TRS benefits.

Benefits to a surviving spouse

A surviving spouse who receives a lump-sum payment of accumulated contributions, survivor benefits, or both may elect to roll over the taxable portion of the payment. A rollover is a payment of the taxable benefit to an individual retirement arrangement (IRA). A rollover can be made in two ways – either the benefit is paid directly to the IRA (this is referred to as a “direct rollover”) or the payment is paid to the surviving spouse who must rollover the payment within 60 days.

If a direct rollover is not elected, the amount that could have been directly rolled over will be subject to mandatory 20 percent federal income tax withholding requirements.

Direct rollovers by a surviving spouse

Surviving spouses who are entitled to receive a payment eligible for rollover may elect a direct rollover. In a direct rollover, TRS pays the taxable portion of the payment directly to an eligible plan, account, or annuity on the behalf of the surviving spouse. The amount rolled over is not subject to income tax until it is distributed from the eligible plan, account, or annuity. A surviving spouse can rollover the lump-sum payment of death benefits to one financial institution and the lump-sum payment of accumulated contributions to another financial institution.

A surviving spouse who wants a direct rollover should contact an eligible plan, account, or annuity sponsor (usually a financial institution) to find out whether it will accept a direct rollover and if so, how to have the payment paid in a direct rollover to the plan at that institution. A surviving spouse who is unsure of how to invest the money can temporarily establish an IRA to receive the payment. However, in choosing an IRA, consideration should be given to whether the IRA will allow a transfer of all or part of the money to another eligible plan, account, or annuity at a later date without penalties or other limitations. See IRS Publication 590, *Individual Retirement Arrangements*, for more information on IRAs. Before a direct rollover is made, both the surviving spouse and the financial institution that is to receive the rollover must certify to TRS that the financial institution is eligible to and will receive the direct rollover.

Direct rollovers are subject to the following limitations:

- The nontaxable portion of a payment cannot be rolled over. For this reason, the nontaxable amount will automatically be paid directly to the surviving spouse. The nontaxable amount is not subject to withholding requirements.
- If the taxable portion of the payment is less than $200, it is not eligible for a direct rollover and is not subject to 20 percent federal income tax withholding.
- If the taxable portion of the payment is more than $500, the surviving spouse may elect to receive part of the payment and have the balance directly rolled over into an eligible plan, account, or annuity; however, the direct rollover must be at least $500.
- If the taxable portion of the payment is less than $500 and greater than $200, the surviving spouse must either receive 100 percent or have 100 percent of the taxable portion directly rolled over.
- The portion, if any, of a payment that is a “required minimum payment” under federal law cannot be rolled over.

The application for benefits that the surviving spouse completes includes a direct rollover election section and the required certifications by the surviving spouse and the receiving financial institution. **If the direct rollover election is not completed, TRS will assume that the surviving spouse has elected to receive the payment subject to 20 percent mandatory withholding for federal income tax.**

Payments to a surviving spouse

If the surviving spouse elects to receive all or a portion of the payment, the taxable amount received is subject to mandatory 20 percent federal income tax withholding. For example, if the surviving spouse is entitled to a taxable payment of $10,000, only $8,000 will be paid because TRS must withhold $2,000 for federal income tax. However, when the surviving spouse prepares his or her tax return, the full $10,000 will be reported as the taxable payment. The $2,000 will be reported as tax withheld and will be credited against any income tax owed for that year.

If a surviving spouse receives a payment that could have been directly rolled over to an IRA, the surviving spouse may still roll over all or part of the taxable portion of the payment including the amount withheld if the surviving spouse has other funds available to make up the difference. However, the rollover must occur within 60 days of receipt of the payment.

For example, assume the surviving spouse is eligible to receive a taxable distribution of $10,000 and elects to receive the entire amount. The surviving spouse will actually receive only $8,000 because $2,000 (20 percent) must be withheld for federal income tax. Within 60 days after receiving the payment, the surviving spouse may elect to roll over the entire $10,000 to an IRA. To make the rollover, the surviving spouse must find $2,000 from other sources (*e.g.,* savings, loan). In this case, the entire $10,000 is not taxed until withdrawn from the IRA.

However, if the surviving spouse had rolled over only $8,000, the $2,000 is taxed in the year it was withheld.

Federal tax withholding

Lump-sum payments to the surviving spouse of a deceased member are subject to mandatory 20 percent withholding for federal income tax. The only way a surviving spouse can avoid the mandatory withholding is to elect that the taxable portion of the payment due be directly rolled over to an IRA. Monthly annuity payments are not subject to the 20 percent mandatory withholding requirement; however, they are subject to the voluntary withholding rules described below. (Note: The $1,000 one-time payment that is issued with the election of a monthly benefit is subject to the 20 percent withholding unless directly rolled over.)

Voluntary. The following payments are subject to voluntary federal income tax withholding:

- Monthly annuity or lump-sum payments made to beneficiaries who are not spouses.
- Monthly annuity payments to surviving spouses.

Beneficiaries may elect that federal income tax not be withheld from their monthly annuity payments by completing and filing with TRS a W-4P, Withholding Certificate For Pension or Annuity Payments form. TRS is required to withhold federal income tax based on the rate of a married individual with three exemptions if no W-4P form is filed with TRS.

Tax reporting for all TRS payments

The Office of the Comptroller will send Form 1099-R to the beneficiary and the IRS reporting the amount paid (including direct rollovers) during a calendar year. In addition to showing the amount paid, the Form 1099-R will report the portion that is taxable, the amount of federal income tax withheld, if any, and any amount directly rolled over.

State income tax

Benefits received from TRS are not subject to Illinois income tax. Beneficiaries who reside in other states should check with their state's Department of Revenue for information concerning the taxability of benefits.

How to obtain additional information

The *Employer Guide* only summarizes tax rules that might apply to a member's payment. The rules described are complex and contain many conditions and exceptions that are not included in this guide. Therefore, members or beneficiaries may want to consult with a professional tax advisor before they take a payment of benefits from TRS. More specific information on tax treatment of payments from qualified retirement plans can be found in IRS Publication 575, *Pension and Annuity Income* and IRS Publication 590, *Individual Retirement Arrangements*. These publications are available at www.irs.gov, from local IRS offices, or by calling 1-800-TAX-FORMS.